12-2943-cv

To Be Argued By:
ROBERT G. HEIM

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

—against—

BRENT C. BANKOSKY,
Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANT-APPELLANT

ROBERT G. HEIM
MEYERS & HEIM LLP
444 Madison Avenue, 30th Floor
New York, New York 10022
(212) 355-7188

Attorneys for Defendant-Appellant

TABLE OF CONTENTS

PRELIMINARY STATEMENT 1

ARGUMENT 3

I. THE DISTRICT COURT ABUSED ITS DISCRETION IN BARRING BANKOSKY FROM ACTING AS AN OFFICER OR DIRECTOR OF A PUBLIC COMPANY FOR TEN YEARS 3

A. The Frequency With Which Courts of Appeals Reverse District Court Decisions to Impose Officer and Director Bars is Irrelevant 3

B. The Patel Analysis is Applicable and the District Court Incorrectly Weighed the Patel Factors 3

1. Bankosky's Conduct Does Not Meet the Threshold that Courts Use to Determine Whether Conduct is Egregious 4

2. Bankosky Did Not Act with a High Degree of Scienter.........................7

3. Bankosky's Position at Takeda was not that of a Corporate Officer or Director 8

4. Bankosky is Unlikely to Commit Future Violations 10

5. Bankosky's Conduct did not Result in Significant Economic Gain.....11

II. BANKOSKY'S CONDUCT DOES NOT WARRANT AN OFFICER AND DIRECTOR BAR UNDER THE COMMISSION'S ALTERNATIVE ANALYSIS 12

A. The Patel Factors Remain Applicable to the "Unfitness" Standard 12

B. The Commission's Alternative Analysis is Inapplicable to Officer and Director Bars 13

CONCLUSION 21

TABLE OF AUTHORITIES

Cases

CFTC v. Wilshire Investment Management Corp., 531 F.3d 1339, 1347 (11th Cir. 2008) 10

Chiarella v. U.S., 445 U.S. 222 (1980)....................7

Gonchar v. SEC, 409 Fed. Appx. 396, 400 (2d Cir. 2010)....................18

Hecht Co. v. Bowles, 321 U.S. 321, 329 (1944) 16

SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1244-1245 (S.D.N.Y. 1976).....16

SEC v. *Colonial Inv. Mgmt. LLC,* 381 Fed. Appx. 27, 31 (2d Cir. 2010)....................3

SEC v. Commonwealth Chem. Sec., 574 F.2d at 90, 99 (2d Cir. 1978) 14

SEC v. Drucker, 528 F. Supp.2d 450, 453-54 (S.D.N.Y. 2007)....................6

SEC v. Fisher, 2012 WL 3757375, *15, 2012 U.S. Dist. LEXIS 122144, 39-40 (N.D. Ill. Aug. 28, 2012)....................11

SEC v. Huff, 758 F.Supp.2d 1288, 1356 (S.D. Fla. 2010) 9

SEC v. iShopNoMarkup.com, Inc., Fed. Sec. L. Rep. (CCH) P96,762, 2012 U.S. Dist. LEXIS 28179 (E.D.N.Y. Mar. 3, 2012) 12

SEC v. Leffers, 289 Fed. Appx. 449, 452 (2d Cir. 2008)....................4

*SEC v. Lorin,*76 F.3d 458, 461 (2d Cir. 1996)....................10

SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1102 (2d Cir. 1972)............15

SEC v. Mulcahey, 311 F. App'x 509, 511 (2d Cir. 2009) 11

*SEC v. Pallais,*2010 WL 2772329, at *9-10 (S.D.N.Y. July 9, 2010) 4

SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995) 1, 3, 4, 12, 13, 19

SEC v. *Posner,* 16 F.3d 520,521 (2d Cir. 1994)...3

SEC v. Quinlan, 373 F. App'x 581, 588 (6th Cir. 2010).......................................10

SEC v. Resnick, 604 F. Supp.2d 773, 783-84 (D.Md. 2009)....................................5

SEC v. Robinson, 2002 WL 1552049, at *5 (S.D.N.Y. July 16, 2002).....................5

SEC v. Stanard, 2009 WL 196023, at *33 (S.D.N.Y. Jan. 27, 2009)......................12

SEC v.Sprecher, 81 F.3d 1147 (table), 1996 WL 175216, *4 (D.C. Cir. Apr. 9, 1996) 9

United States v. Chestman, 947 F.2d 551, 567 (2d Cir. 1991).................................6

United States v. Chiarella, 588 F.2d 1358, 1366 (2d Cir. 1978), *rev'd,* 445 U.S. 222 (1980)...6

United States v. Rigas, 490 F.3d 208 (2d Cir. 2007)...11

Statutes and Rules

Insider Trading Sanctions Act ("ITSA"), 15 U.S.C. § 78a.....................................14

Pub. L. 107-204, §305(a)(1) 1

Rule 144, 17 C.F.R. § 230.144 9

Section 20(b) of the '33 Act, 15 U.S.C. § 77t(b) 14

Section 209(d) of the '40 Act, 15 U.S.C. § 80b-9(d) 14

Section 21(d)(1) of the '34 Act, 15 U.S.C. § 78u(d)(1) 14, 15, 19

Other Authorities

148 CONG. REC. H1544 (daily ed. Apr. 24, 2002). 19, 20

148 CONG. REC. S6013 (daily ed. June 25, 2002) 20

148 CONG. REC. S6543 (daily ed. July 10, 2002) 20

Philip F.S. Berg , *Unfit To Serve: Permanently Barring People from Serving as Officers and Directors of Publicly Traded Companies After the Sarbanes-Oxley Act*, 56 Vand. L. Rev. 1871, 1844 (Nov. 2003). 20

PRELIMINARY STATEMENT

There is no dispute in this appeal that, in order to impose an officer-director bar, a district court must find: (1) that a securities law violation occurred; and (2) that the individual who committed a securities law violation is unfit to serve as an officer or director of a public company. Pub. L. 107-204, §305(a)(1). The Commission's brief does not dispute this basic test of unfitness, but rather bases the bulk of its argument on the misguided proposition that the *Patel* decision, *SEC v. Patel,* 61 F.3d 137, 141 (2d Cir. 1995), is no longer applicable because Congress amended the statutory provision in Sarbanes-Oxley to read "unfitness" instead of "substantial unfitness." Indeed, although the *Patel* decision predates the amendment which changed the test to unfitness, courts continue to apply the *Patel* factors to determine if an individual is "unfit" to serve as an officer or director of a public company, modifying their analyses to account for the change from "substantial unfitness" to "unfitness." The Commission's argument that a different standard from the one which has been established by precedent should be used is unavailing – the *Patel* factors are applicable regardless of whether the court is considering if an individual is "unfit" or "substantially unfit."

Further, the Commission's claim that Bankosky's conduct was egregious is both misleading and unsupported by any of the findings below. Indeed, the district court expressly found that Bankosky's conduct "lack[ed] certain other aspects that

courts usually rely on when finding securities law violations to be egregious." A-173. While the facts contained in the Commission's Complaint were to be taken as true, according to the Consent Judgment entered into by the parties, those facts simply did not support a finding that Bankosky's conduct was egregious, as the district court correctly acknowledged in its finding. Consent Judgment, A25.

As for the Commission's claim that Bankosky manifested a high degree of scienter, his inability to recall events which occurred more than two years earlier hardly suggest that he acted with scienter. Moreover, the Commission's attempt to argue that Bankosky's position at Takeda weighs in favor of affirming the ten-year bar is based on erroneous assumptions. Bankosky was never an officer or director at Takeda, and the precedent clearly weighs against imposing officer and director bars on individuals who are not senior corporate officers. Indeed, the District Court courtly acknowledged that Bankosky was not an officer or director at Takeda.

Finally, the Commission's claim that Bankosky is reasonably likely to commit future violations is entirely baseless, particularly in a case where Bankosky voluntarily entered into a Consent Judgment with the Commission concerning its allegations, consenting to all of the Commission's requested relief other than the officer and director bar. Bankosky had a right to argue that his conduct did not

merit an officer and director bar under the *Patel* factors. Further, the speculation that Bankosky's occupation may present opportunities for future securities violations does not evidence a likelihood of future misconduct.

ARGUMENT

I. THE DISTRICT COURT ABUSED ITS DISCRETION IN BARRING BANKOSKY FROM ACTING AS AN OFFICER OR DIRECTOR OF A PUBLIC COMPANY FOR TEN YEARS

A. The Frequency With Which Courts of Appeals Reverse District Court Decisions to Impose Officer and Director Bars is Irrelevant

While the Commission attempts to argue, at 24-25, that Courts of Appeals rarely, if ever, reverse district court decisions to impose officer and director bars, an absence or dearth of appellate case law does not effectively affirm any district court opinion, regardless of its merit. Rather, the appellate court is subject to a standard of review, which is whether the lower court abused its discretion in entering its Order finding that Bankosky was unfit to serve as an officer or director of a public company and barring Bankosky from such positions for a period of ten years. *See SEC* v. *Colonial Inv. Mgmt. LLC,* 381 Fed. Appx. 27, 31 (2d Cir. 2010); *SEC* v. *Posner,* 16 F.3d 520,521 (2d Cir. 1994).

B. The Patel Analysis is Applicable and the District Court Incorrectly Weighed the Patel Factors

The Commission attempts to persuade the Court, at 26, 43-59, that the *Patel* analysis is wholly inapplicable simply because a less rigorous overall standard has

been mandated by Sarbanes-Oxley. *SEC v. Leffers*, 289 Fed. Appx. 449, 452 (2d Cir. 2008), decided after the 2002 amendment which changed the standard to "unfitness," confirms that courts continue to use the *Patel* factors to evaluate whether or not to impose an officer and director bar while considering the less rigorous standard. *SEC v. Leffers,* 289 Fed. Appx. at 452 (noting that the Court reviewed the *Patel* factors which might be considered by a district court in resolving the issue of whether an individual's conduct makes him or her unfit to serve as an officer or director).

1. Bankosky's Conduct Does Not Meet the Threshold that Courts Use to Determine Whether Conduct is Egregious

First, the Commission argues, at 28-31, that the district court "unduly favor[ed]" Bankosky in its analysis of whether his conduct was egregious. The Commission further attempts to paint Bankosky as taking part in a "consistent pattern of repeated misconduct." The Commission claims "the court's opinion cites and describes the conduct in three cases where *permanent* bars were imposed." While the Commission claims a permanent bar was imposed in *SEC v. Pallais,*2010 WL 2772329, at *9-10 (S.D.N.Y. July 9, 2010), the court in fact imposed a limited, ten year bar for a case involving far more egregious violations than those of Bankosky. Pallais had been the CEO and Chairman of Rodedawg International Industries, Inc. and had violated section 10(b) of the Exchange Act

and Rule 10b-5 by issuing thirty materially false and misleading press releases about Rodedawg's business and future prospects over a period of 18 months.

In the other case which the Commission cites, *SEC v. Resnick,* 604 F. Supp.2d 773, 783-84 (D.Md. 2009), the individual against whom a lifetime bar was imposed was criminally convicted and had played a central role in a fraudulent scheme to inflate and overstate the financial results of two companies by over $700 million, for at least two fiscal years, while he was a Chief Marketing Officer and member of their executive committees. The court found that in light of the gravity of the fraud here, "which is itself egregious, and in light of the fact that Mr. Kaiser both played a central role in and had a major economic stake in that fraud," that a lifetime bar was appropriate.

Then, the Commission cites, *SEC v. Robinson,* 2002 WL 1552049, at *5 (S.D.N.Y. July 16, 2002), a case in which the Commission alleged that Robinson, an officer and director of CVCA, obtained at least $400,000 from investors by fraudulently inducing them to purchase stock in CVCA through false and misleading offering material on the internet and in national advertisements, which he allegedly authored. In addition, Robinson made an additional offering of CVCA securities *after* the issuance of a preliminary injunction against him. The cases which the Commission cites in order to argue that the district court may have "favored" Bankosky by not imposing a permanent bar involve egregious patterns

of misconduct that involved senior officials. By contrast, the district court correctly found that Bankosky's conduct was not egregious, citing these cases as examples of what constituted egregious conduct.

The Commission also argues that insider trading has been held to warrant a permanent officer and director bar. To support its proposition, the Commission cites *SEC v. Drucker,* 528 F. Supp.2d 450, 453-54 (S.D.N.Y. 2007), *aff'd,* 346 F. App'x 663 (2d Cir. 2009). In *Drucker,* Mitchell Drucker was an attorney who betrayed the trust of his client, whom the district court believed had perjured himself and whose misconduct was described as "brazen." The case involved unique facts which weighed in favor of the imposition of permanent bar, exclusive of whether or not the violations involved insider trading.

The Commission claims, at 30, that "insider trading violations can be egregious." For its proposition, the Commission cites *United States v. Chestman,* 947 F.2d 551, 567 (2d Cir. 1991) and *United States v. Chiarella,* 588 F.2d 1358, 1366 (2d Cir. 1978), *rev'd,* 445 U.S. 222 (1980). In *Chestman*, however, the Court simply noted, "Our Rule 10b-5 precedents under the misappropriation theory, moreover, provide little guidance with respect to the question of fiduciary breach, because they involved egregious fiduciary breaches arising solely in the context of employer/employee associations," and did not find that any conduct was egregious. In addition, the Commission cites *Chiarella* in support of its contention that insider

trading violations can be egregious, but any finding of an insider trading violation was reversed in *Chiarella v. U.S.,* 445 U.S. 222 (1980). Chiarella's convictions were reversed where the Court found that his failure to disclose non-public market information prior to trading was not fraudulent because he did not have a relationship with the sellers for imposing an affirmative duty to disclose such information.

2. Bankosky Did Not Act with a High Degree of Scienter

Second, the Commission attempts to argue, at 32-34, that Bankosky "manifested a high degree of scienter" because of his inability to recall events that took place two years prior to his testimony to the Commission and that he knew of, and worked on, the Cell Genesys transaction based on the e-mails the Commission attached to its motion for an officer and director bar. While the Consent Judgment entered into between Bankosky and the Commission deemed the allegations in the Complaint to be true for the purposes of the Commission's motion for an officer and director bar, the e-mails the Commission attached to its motion were not part of the facts to which Bankosky consented and the District Court improperly made conclusions which were not supported by the allegations in the Complaint. Further, simply because Bankosky could not recall events which took place two years prior to his testimony does not evidence that he acted with scienter. The

Commission failed to set forth any other evidence of scienter not admitted to in the Consent Judgment.

3. Bankosky's Position at Takeda was not that of a Corporate Officer or Director

Third, the Commission asserts, at 35-37, that Bankosky "held a sensitive position that carried with it a high level of trust." Contrary to the Commission's baseless assertions, Bankosky was not a corporate officer or director of Takeda, as correctly noted by the district court. A-174. The Commission's complaint does not evidence that Bankosky was acting in a corporate or fiduciary capacity when he carried out the securities trades at issue or that he was an officer or director of Takeda. By contrast, Bankosky was a low level employee at Takeda who did not have any supervisory responsibilities or any other duties that would make him an officer or director of Takada or any other company.

Further, the Commission attempts to disregard precedent, at 36, particularly in the Second Circuit, in which officer and director bars almost uniformly involve misconduct by senior corporate officers and egregious corporate governance and financial reporting frauds, by arguing that it does not matter whether or not an individual "held the precise office of officer and director." The Commission fails to acknowledge that while it does not matter if an individual is actually called an officer or director, courts still consider the individual's actual control within a company.

The Commission's own cases, which it cites in support of its misguided argument, involve egregious corporate governance and financial reporting fraud. In *SEC v. Huff*, 758 F.Supp.2d 1288, 1356 (S.D. Fla. 2010), Huff, along with others, siphoned tens of millions of dollars from a professional employee leasing organization. Huff was a control person for the employee leasing organization and participated in all crucial aspects of its business, although he hid his involvement by not being named an officer or director. The Commission asserted that Huff and others artificially inflated the employee leasing organization's financial condition and failed to disclose related party transactions that benefitted Huff and the others.

In *SEC v.Sprecher,* 81 F.3d 1147 (table), 1996 WL 175216, *4 (D.C. Cir. Apr. 9, 1996), Sprecher and two associates devised a plan to acquire a majority shareholder's stock in World Wide, to merge World Wide with another company, and then to sell the stock for profit. In order to free the stock from registration requirements, Sprecher falsely made it appear that the exception created by Rule 144, 17 C.F.R. § 230.144, applied. The stock was purchased, the merger took place, and the unrestricted, unregistered shares were sold at a profit. In affirming the officer and director bar, the Court noted that Sprecher had a controlling, fiduciary role in World Wide equivalent to an officer or director's role and his security laws violations were flagrant and deliberate.

4. Bankosky is Unlikely to Commit Future Violations

Fourth, the Commission simply rehashes the District Court's erroneous finding, at 37-41, that Bankosky is likely to commit future violations because of his attempts to defend himself against the imposition of an officer and director bar. In support of its argument, the Commission cites *SEC v. Lorin,* 76 F.3d 458, 461 (2d Cir. 1996) and *SEC v. Quinlan,* 373 F. App'x 581, 588 (6th Cir. 2010). In *Lorin*, defendants were actually found guilty of violating the federal securities laws, unlike Bankosky, who simply entered into a Consent Judgment with the Commission. Further, unlike the defendant in *Quinlan*, Bankosky has not attempted to withdraw a guilty plea, but simply has argued against the imposition of an officer and director bar, to which he did not consent in the Consent Judgment.

Moreover, the Commission grossly mischaracterizes limited excerpts of Bankosky's testimony as "not only untruthful" but "so blatantly deceptive that it made a mockery of the investigation." However, the Commission cites *CFTC v. Wilshire Investment Management Corp.,* 531 F.3d 1339, 1347 (11th Cir. 2008), which is easily distinguishable. Not only did *Wilshire Investment* not involve the imposition of an officer director bar, but rather concerned a bar against commodity-related activity, including soliciting customers and funds, but the defendants did not enter into a consent judgment with the CFTC in that matter, and

the defendants' conduct involved sales to at least nine customers; this conduct has some relevance to the imposition of a bar against soliciting customers.

In addition, the Commission attempts to argue that Bankosky is an attractive candidate for "similar future employment," suggesting he was a member of "senior management" at a publicly traded company in 2011. Arguing that an officer and director bar should be imposed simply because an individual could re-enter the workforce is "speculation" and "on top of that speculation one would have to further speculate that in [his] (hypothesized) working life [he] would be reasonably likely to offend again." *SEC v. Fisher*, 2012 WL 3757375, *15, 2012 U.S. Dist. LEXIS 122144, 39-40 (N.D. Ill. Aug. 28, 2012).

5. Bankosky's Conduct did not Result in Significant Economic Gain

Fifth, the Commission dismisses, at 41-42, Bankosky's lack of significant gain as irrelevant to the imposition of an officer and director bar, citing *SEC v. Mulcahey,* 311 F. App'x 509, 511 (2d Cir. 2009). While the defendant in *Mulcahey*, a Vice President and Assistant Treasurer at a public television company, did not profit from his fraud, he was found guilty of numerous securities law violations, which included preparing and submitting fraudulent loan compliance reports in a massive securities fraud (as described in a related criminal proceeding, at *United States v. Rigas*, 490 F.3d 208 (2d Cir. 2007). Bankosky's economic stake in the transactions was very modest and his losses almost canceled out any gain.

6. The Fact that Bankosky was not a Repeat Offender Weighs Heavily Against the Imposition of an Officer-Director Bar

Sixth, the Commission attempts to argue, at 42-43, that the fact that Bankosky was not a repeat offender does not weigh against the imposition of a ten-year bar. Indeed, the fact that a defendant has never violated securities laws prior to the events giving rise to the litigation before the court "weighs heavily against the imposition of an officer director bar." *SEC v. iShopNoMarkup.com, Inc.*, Fed. Sec. L. Rep. (CCH) P96,762, 2012 U.S. Dist. LEXIS 28179 (E.D.N.Y. Mar. 3, 2012), *citing SEC v. Stanard,* 2009 WL 196023, at *33 (S.D.N.Y. Jan. 27, 2009) (finding defendant's "lack of previous securities law violations" to be "particularly relevant" in its balance of the *Patel* factors which weighed against the imposition of an officer and director bar).

II. BANKOSKY'S CONDUCT DOES NOT WARRANT AN OFFICER AND DIRECTOR BAR UNDER THE COMMISSION'S ALTERNATIVE ANALYSIS

A. The Patel Factors Remain Applicable to the "Unfitness" Standard

Finally, the Commission sets forth, at 43-59, a convoluted discussion of the "inflexible" *Patel* analysis and its use by district courts and the difficulty of obtaining office and director bars against individuals who have violated federal securities laws. The Commission dismisses, at 43, the *Patel* factors as "overruled" by the Sarbanes-Oxley amendment that changed the statutory standard to "unfitness." However, applying the *Patel* factors does not dilute the statutory

amendment – courts ultimately use the *Patel* factors to determine if the person's misconduct demonstrates the statutory standard of unfitness to serve as an officer or director.

The Commission claims, at 44, "Congress' express purpose in empowering the federal courts to issues such bars was to 'combat recidivism and protect investors' and to 'strengthen the remedial effect of the SEC's enforcement program,'" while presenting no evidence of how such a bar would combat recidivism in Bankosky's case, where Bankosky is a first-time offender who has never held the position of an officer or director and whose violations were not egregious. The Commission claims, at 45-48, that district courts have adopted an inflexible view of the *Patel* analysis, which in part places too much emphasis on defendant's repeat offender status, and makes "it difficult for the Commission to obtain permanent bars in many egregious cases of securities fraud."

Regardless of the test applied, the analysis of whether Bankosky is unfit to serve as an officer or director would yield the same result – that Bankosky's misconduct simply does not merit the imposition of an officer and director bar.

B. The Commission's Alternative Analysis is Inapplicable to Officer and Director Bars

The Commission argues, at 56, that the Second Circuit should adopt the analysis used when determining whether injunctive relief is appropriate. The factors the Commission proposes would include: the fact that defendant has been

found liable for illegal conduct; the degree of scienter involved; whether the infraction is an "isolated occurrence;" whether defendant continues to maintain that his past conduct was blameless; and whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated. *SEC v. Commonwealth Chem. Sec.,* 574 F.2d at 90, 99 (2d Cir. 1978). The Commission argues, at 57, that this Court should espouse an analysis where, "the entire thrust of the analysis is directed at deciding whether it is reasonably likely that the defendant poses a future threat to investors such that he should be enjoined."

Section 20(b) of the '33 Act, 15 U.S.C. § 77t(b), Section 21(d)(1) of the '34 Act, 15 U.S.C. § 78u(d)(1), and Section 209(d) of the '40 Act, 15 U.S.C. § 80b-9(d), each give federal courts the power to enjoin "any person [who] is engaged, or is about to engage, in acts or practices" which constitute or will constitute a violation. Historically, an injunction was often the Commission's only option for a remedy. From the Commission's inception in 1934, until the Insider Trading Sanctions Act ("ITSA"), 15 U.S.C. § 78a, was passed in 1984, an injunction was the primary tool available to the Commission, as even the civil penalty authority was very narrow at that time. Amendments to ITSA, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, and the Sarbanes-Oxley Act of 2002 have given the Commission a broad range of remedies, which include the

officer and director bar. Section 21(d)(1) of the '34 Act provides that, "the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section 10(b) ... or the rules or regulations thereunder from acting as an officer or director ... if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer."

By contrast, Section 20(b) of the '33 Act and Section 209(d) of the '40 Act enable the Commission to seek a "temporary or permanent injunction" against "any person [who] is engaged or is about to engage in acts or practices constituting a violation" of the securities laws. There need be only a reasonable likelihood that the activity complained of will be repeated. *See SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1102 (2d Cir. 1972).

The standard for an injunction simply is not equivalent to that for barring an individual from serving as an officer or director of a public company. The latter requires a finding that the individual is "unfit" to serve as an officer or director, while the former is based on the likelihood of future violations. If Congress intended for courts to use the same standard to evaluate both remedies, the same standard would have been specified. As such, the standard for an officer and director bar depends on an individual "unfitness" to serve. The Commission states, at 55, that "officer and director bars were specifically intended by Congress 'to

protect public investors from persons who, by engaging in fraudulent conduct, have already demonstrated that they should not be entrusted with authority over investor funds' in the future." Meanwhile, an injunction has been described as, "historically designed to deter, not to punish." *SEC v. Bausch & Lomb, Inc.*, 420 F. Supp. 1226, 1244-1245 (S.D.N.Y. 1976), *citing Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944). The very purposes of the remedies are different – the officer and director bar serving to protect public investors and the injunction serving to deter future violations. For this reason, the analysis for each remedy is distinct and the *Patel* factors take into consideration a variety of factors that may indicate whether an individual may be unfit to serve in order to protect public investors.

Indeed, when evaluating the need to protect public investors, as the Commission identified as the purpose of the statute allowing for officer and director bars, Bankosky, who is not and was not an officer or director, is highly unlikely to harm public investors in the future. The Commission argues that this Court should adopt the same standard for issuing officer and director bars that is in place for determining whether an individual should be barred from association with a broker-dealer or investment adviser. Commission Br. pp. 56-59. This argument is fundamentally flawed because the statutory scheme that Congress enacted that governs bars from association with broker-dealers and investment advisors is a

separate and distinct statute with a very different standard for determining whether a bar should issue or not.

Specifically, Exchange Act Sections 15(b)(4)(e) and (b)(6) and Advisers Act Section 203(f) authorize the Commission to suspend or bar a person from association with a broker, dealer, or investment adviser if it determine that the person has, among other things, willfully violated the federal securities laws and it is in the public interest to do so. 15 U.S.C. §§ 70o (b)(4)(e), 70o(b)(6), 80b-3(f). Congress deliberately set the standard lower for the issuance of bars from association with broker-dealers and investment advisers because that standard only requires a willful violation of *any* provision of the federal securities laws. In contrast, the statute governing the issuance of officer and director bars requires that the individual have committed a violation of the *antifraud* provisions of the federal securities laws. Moreover, the statute governing the issuance of bars from association with a broker-dealer or investment adviser does not require that a finding be made that the person is unfit to be associated with a broker-dealer or investment adviser. It only requires a lower threshold of the bar being in the public interest. Clearly these two statutory schemes are very different and the Commission's argument that the standards for issuing the two different kinds of bars should be the same is without support in the statutory language.

By comparison, this Court has affirmed bars prohibiting individuals from association with broker-dealers based on whether it was in the public interest, where the potential for customer harm is obvious. *See, Gonchar v. SEC,* 409 Fed. Appx. 396, 400 (2d Cir. 2010) (affirming barring defendants from association with any broker-dealer based on a "demonstrated pattern ... [of charging] customers excessive markups"); *Sinclair v. SEC*, 444 F.2d 399, 402 (2d Cir. 1971) (affirming permanent bar from association with any broker-dealer against defendant based on defendant's interpositioning which resulted in customers receiving prices other than the best available and resulted in additional commissions for the defendant). Unlike defendants who have the ability to directly harm investors through their misconduct, Bankosky is not an officer or director, nor does he hold a similar position, which would enable him to impart such harm on investors. Taking into consideration the purpose of an officer and director bar, Bankosky is not "unfit" to serve as an officer or director and is unlikely to harm public investors in the future.

The Commission also argues, at 57, that this Court should simply disregard one of the most important factors in the *Patel* analysis, namely whether Bankosky is a repeat offender. As noted in detail in the Commission's brief, numerous courts have reached the conclusion that officer and director bars are simply not appropriate for an individual who is a first time offender. Commission Br. pp. 49-55. The Commission's argument would drastically lower the standard that courts

apply in determining whether an individual is unfit to be an officer or director and this approach is inconsistent with the statutory scheme that Congress enacted. While Congress may have intended to slightly lower the burden the Commission must meet in obtaining an officer and director bar when it changed the finding that is required from "substantially unfit" to "unfit," there is no indication that Congress intended to lower the burden as drastically as the Commission now advocates. In fact, the legislative history of Section 21(d) demonstrates that Congress was well aware of the high burden that is imposed on the SEC when it seeks officer and director bars and Congress kept that high burden in place to ensure that officer and director bars were used in only the most egregious cases where an individual is a repeat offender and the other remedies at the SEC's disposal – such as injunctions and civil penalties – did not have the intended deterrent effect.

The legislative history shows that on April 24, 2002, the House of Representatives passed a draft of the bill that would eventually become the Sarbanes-Oxley Act. 148 CONG. REC. H1544 (daily ed. Apr. 24, 2002). In its section on officer and director bars, the House draft tracked, for the most part, the judicial standard for substantial unfitness from *Patel*. "The House's draft, however, would have made enforcement by the SEC easier. . .[T]he House version's explanation of what constitutes substantial unfitness contained only five

of the six elements of the Patel II test, dropping the repeat offender consideration." Philip F.S. Berg , *Unfit To Serve: Permanently Barring People from Serving as Officers and Directors of Publicly Traded Companies After the Sarbanes-Oxley Act*, 56 VAND. L. REV. 1871, 1844 (Nov. 2003).

Section 11(b) of this bill provided a four part statutory test for the first that would define what constituted substantial unfitness. 148 CONG. REC. H1544. However, the Senate version of what became the Sarbanes-Oxley Act initially did not give the Commission administrative authority to issue officer and director bars. 148 CONG. REC. S6013 (daily ed. June 25, 2002). On July 10, 2002, then Senate minority leader Trent Lott (R. Miss.) offered an amendment regarding officer and director bars that changed the standard from "substantial unfitness" to "unfitness" and, notably, did not adopt the House draft of the bill which would have eliminated the prong of the *Patel* test that considered whether an individual was a repeat offender. The Lott amendment was passed by a vote of 97-0 and was included in the final version of the Senate bill. 148 CONG. REC. S6543 (daily ed. July 10, 2002).

Assuming *arguendo* that the Court agrees with the Commission's suggestion that the same analysis for injunctions be used to determine whether an officer or director is "unfit," a balancing of the factors would nonetheless weigh against the imposition of an officer and director bar against Bankosky, as (1) Bankosky was

not found liable for illegal conduct, but rather accepted responsibility by entering into a Consent Judgment, (2) as discussed in Bankosky's Appellate Brief, pp. 19-20, Bankosky did not possess a high degree of scienter, (3) Bankosky's violations were isolated, in that the violations alleged by the Commission are the only violations Bankosky has ever been alleged to have committed, (4) Bankosky does not maintain that his conduct was blameless, but rather, entered into a Consent Judgment and has simply argued against the imposition of an officer and director bar, (5) it is far too speculative to guess that Bankosky will ever be in a position in which securities violations could be anticipated. As a whole, it is unlikely that Bankosky, who consented to an entry of Judgment against him, poses a future threat to investors.

CONCLUSION

For the reasons stated above, Bankosky respectfully requests that this Court reverse or vacate the District Court's Order.

Respectfully submitted,

Dated: February 6, 2013

/s/ Robert G. Heim

Robert G. Heim
MEYERS & HEIM LLP
444 Madison Avenue, 30th Floor
New York, NY 10022
(212) 355-7188

Counsel for Appellant Brent C. Bankosky

Certificate of Compliance

I hereby certify that the foregoing Reply Brief for Defendant-Appellant complies with the 7,000 word type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(ii) in that it contains 4,962 words, excluding the table of contents, table of authorities, and certificates of counsel. The number of words was determined through the word-count function of Microsoft Word. Counsel agrees to furnish to the Court an electronic version of the brief upon request.

Dated: February 6, 2013

/s/ Robert G. Heim
Robert G. Heim